Interview by Navigant Consulting
with Lawrence Grissom

at footnote(s):

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Memorandum

To: SDCERS file

From: Amanda Massucci and Steve Stanton

Date: December 18, 2005

Re: Larry Grissom, SDCERS Administrator

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On December 13, 2005, Amanda Massucci and Steve Stanton met with Larry Grissom, SDCERS Administrator, in the Law Library at the SDCERS' office. Mr. Grissom's counsel, Brian Hennigan, Dan Lefler and Glenn _______ , participated in the meeting. Bruce Ashton, from RLRC, also attended the meeting.

This memorandum summarizes the interview, and is not a verbatim transcript of the interview. We have incorporated into this memorandum our thought processes and analysis, including the choice of which questions and answers were sufficiently significant to memorialize. This memorandum has not been shown to or reviewed, signed, approved or adopted by Mr. Grissom or his counsel.

We began the interview by providing a copy of the interview notice from RLRC to Mr. Grissom. He and his counsel did not have any questions.

__Background__

Mr. Grissom became the SDCERS Administrator on July 7, 1987. He has always reported directly to the Board.

From 1987 to 2000, he received performance evaluations on a sporadic basis. Mr. Pierce formalized the process when he became Board President in 2000. The Board set goals for him in 2001. Approximately 18 months later, the Board evaluated him against those goals. Mr. Pierce and John Torres and J______ served on the committee who evaluated his performance. He typically met only with Mr. Pierce to discuss his performance. Discussions regarding his evaluation and compensation were held in closed session.

Upon his employment at SDCERS through 2004, Mr. Grissom was involved with CALAPARS. He served on the Board of Directors for approximately 16-17 years and held various leadership positions, including vice president, president and chair of the program committee. He coordinated training, including developing course materials, for approximately 5 years (ending in 2004). The organization has working groups for accountants, actuaries, administrators, investment consultants and fiduciary counsel. Mr. Grissom said that Connie Hiatt, Bob Blum, Joe Wyatt and Michael Toumanoff were somewhat involved with the fiduciary counsel working group. He stated that some SDCERS Board members attended educational programs.

Fiduciary Counsel

Mr. Grissom recounted that the SDCERS' fiduciary counsel consisted of the following individuals/firms:

- Morrison & Forester (Joe Wyatt & Michael Toumanoff)
- Dwight Hamilton – associated with Frandzel & Share in Los Angeles
- Morrison & Forester (Joe Wyatt & Michael Toumanoff)
- Toumanoff's new firm
- Hanson & Bridget
- Reish, Luftman, Reicher & Cohen

He said that Joe Wyatt was hired initially to advise on retiree health insurance.

Mr. Grissom said that Dwight Hamilton was based in Colorado. The local counsel with whom we worked was Frandzel & Share in Los Angeles; although Mr. Grissom only recalled working with Mr. Hamilton. Mr. Hamilton was hired to advise on the 1996 manager's proposal. After the manager's proposal, SDCERS decided it needed ongoing fiduciary counsel and Morrison & Forester was retained.

Regarding the process for hiring fiduciary counsel, Mr. Grissom stated that SDCERS initiated the contact with Joe Wyatt and Dwight Hamilton. For subsequent fiduciary counsel, SDCERS employed an "RFP" process. After conducting interviews, the Staff made a recommendation to the Board. SDCERS typically enters into one year contracts with fiduciary counsel which may have options to extend the contract.

Regarding the change from Hanson Bridgett, Mr. Grissom said that the contract had expired. The Board needed fiduciary counsel quickly. The current Board President, Peter Preovolos, suggested the Board hire Fred Reish until the RFP process could be completed. Mr. Grissom said that Staff has been interviewing firms and will make a recommendation to the Board at the Board meeting on December 16, 2005.

Regarding the change in fiduciary counsel from Joe Wyatt to Dwight Hamilton, Mr. Grissom did not recall the reason for the change. When asked about questions of lack of responsiveness, Mr. Grissom said he may recall some issues with Mr. Wyatt's responsiveness but did not recall any specifics. Mr. Grissom stated that Mercer recommended Mr. Hamilton.

<u>SDCERS Actuary</u>

When Mr. Grissom began at SDCERS, Towers Perrin was the actuary of record. SDCERS then hired Buck Consultants who was followed by Gabriel Roeder Smith (GRS") in 1992. The selection of the actuary is subject to the same RFP process as described for fiduciary counsel. Mr. Grissom recalled that since GRS was hired, SDCERS underwent at least two RFP processes where GRS was re-selected. In 2005, the Board selected Kiran to be its new actuary.

Mr. Grissom stated that Mr. Roeder was SDCERS' primary contact from 1992 through contract expiration in 2005. Mr. Grissom equated GRS to the "Big 6" accounting firms in that there are a small number of national firms. Mr. Grissom also said that GRS, and Rick Roeder specifically, has several contracts with counties of California and has performed advisory work for state agencies, including CALPRS and CALTRS.

<u>Rate Relief</u>

We began my asking Mr. Grissom about changes to the SDCERS funding method in 1991. Mr. Grissom responded that the change in funding method was a straight forward change. He further responded that it was not a significant event and did not require much discussion. Once the change was requested, Staff gathered the necessary information, including the cost and impact on the System. He said that Buck Consulting provided some assistance, but fiduciary counsel was not consulted on the change. Mr. Grissom did not recall there being any correlation between this change and benefits provided.

Mr. Grissom drew the following diagram to explain the change from EAN to PUC: It shows a decreased funding level in the earlier years with increased funding in the later years. Mr. Grissom explained that the funding levels even out between the two methods over time. Mr. Grissom also explained that he did not recall if the change was a permanent or a temporary change.

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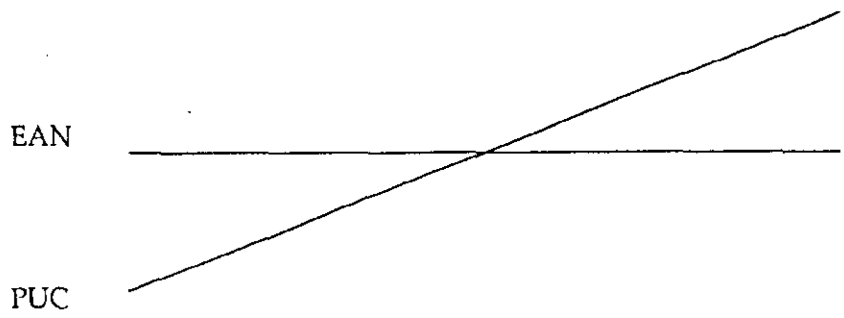

Mr. Grissom also described a change in the amortization period around this time period; although he was not certain if it was the same year or the next year. He recalled that the City Manager, Jack McGrory and Deputy City Manager, Bruce Herring, requested the recasting of the amortization period. He specifically recalled that the System was in the 27th or 28th year of the then current 30-year amortization period and the change reset the amortization period to 30 years. When we asked Mr. Grissom why the change was requested, he responded that they had to do something. He stated that a 30 year amortization period has been common in the public sector.

We asked Mr. Grissom several times during the interview, why the City wanted rate relief. Mr. Grissom responded that he could only speculate so we would have to ask the City for further explanation.

Mr. Grissom also said that the City had given additional benefits to its employees during the meet and confer process in 1989 through 1992, leading up to the change in the funding method and resetting the amortization period. Mr. Grissom responded that he did not know how long it would take the City to catch up to the EAN method.

We asked Mr. Grissom if PUC is a commonly used method for public sector pension plans. Mr. Grissom responded that it is one of the six actuarially accepted methods. He also responded that EAN and PUC are the most common of those six methods. He further responded that EAN has been and continues to be the more commonly used method; however, more entities are beginning to use PUC in current times.

We asked Mr. Grissom if there were other changes to the System before 1996. Mr. Grissom responded that the City implemented minor benefit changes almost every year and began an early retirement program in 1992. He said that the next major change occurred in 1996.

Requests for Rate Relief in 1994 and 1995

When we initially asked Mr. Grissom about the actuarial committee, he did not recall that it had existed. When we shared the minutes from the February 1994 meeting, he recalled the discussions about "rate stabilization". Mr. Grissom explained the volatility in the contribution rate caused by the PUC method, especially due to the actual turnover rates which were lower than the estimated turnover rates used in the actuarial calculation.

Mr. Grissom also explained the discussion of the "funded ratio corridor" concept. He explained that they had discussed a funded ratio "corridor" of 85-105 percent where the contribution does not change unless the funding drops below the lower end of the range.

Mr. Grissom also said that Mayor Golding requested a "contribution holiday" in the 1992-1994 time period. Mr. Grissom explained that other California funds had been achieving very strong investment returns during this period and agreed to discontinue both employee and the employer contributions for a period of time. He said that Keith Enerson was the Board president at that time [1] and Mr. Enerson and the Board rejected the idea.

As an aside, we asked Mr. Grissom about the terms "pick up" and "offset". Mr. Grissom explained that they were two different concepts. The term "pick up" refers to a portion of the employee contribution paid by the employer.

Also as an aside, Mr. Grissom explained the employee contribution rate reserve created out of excess earnings in 1998. It was designed to alleviate the burden on the employees of the increased benefits by using the reserves to cover a portion of the amount that would have been paid by the employees through payroll deductions.. Mr. Grissom said that the reserve is held outside of the System's assets. He also explained that other "held outside of assets" include retiree health insurance, DROP and supplemental COLA. These assets are not factored into the calculation of the funded ratio.

We asked Mr. Grissom if the Board understood the impact of changes in real dollars versus percentages. Mr. Grissom responded that no one knows the impact until July 1st since the actuarial payroll and the budget payroll are always different. He gave an

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[1] We know that Mr. Enerson served as the Board President from 1994 – 1999.

example of $60 million as the difference between actual and budgeted payroll presented in the Pension Reform Committee report. He confirmed that the actual contribution in dollars compared to the ARC was not routinely presented to the Board.

"Earnings Stabilization Reserve"

We asked Mr. Grissom about the March 1995 Board meeting and discussions about lowering the contribution at the City Auditor's request. Mr. Grissom recalled that the City Auditor needed $9.3 million to plug a budget shortfall for FY 1996. He said that Mr. Ryan, the City Auditor, commonly used threats which hit the MEA members the hardest. The safety members knew their departments would not be subject to employee cuts; however, the departments of the MEA members were most at risk to employee cuts.

Mr. Grissom discussed the nature of the one time only nature of Mr. Ryan's request. He stated that Morrison & Forester was consulted on the idea. Mr. Grissom does not recall what happened to the budget in that year. Mr. Grissom said that the requested reduction of $9.3 million was the first time that the Board heard the impact of the actual dollar amounts on the contribution. Mr. Grissom said that he did not believe the request was approved. However, as he reviewed the remainder of the March 1995 minutes, he acknowledged that the proposal had been approved subject to the availability of excess earnings.

<u>1996 Manager's Proposal</u>

When we asked Mr. Grissom who drove the 1996 manager's proposal, he responded Mr. McGrory. When we asked why Mr. McGrory wanted the manager's proposal, Mr., Grissom responded "rate stabilization" and the desire to keep the contribution rate low.

Mr. Grissom discussed the climate at that time, specifically the results of the Claypool litigation where Governor Wilson attempted to extract $1.3 billion from CALPERS. He said that their interpretation of the Claypool decision was that if SDCERS were to grant the City's request for contribution relief, it would need to provide something to the members in return – in this case, enhanced benefits.

We asked Mr. Grissom about a meeting with Mr. McGrory and Mr. Enerson in 1996 to discuss the manager's proposal. Mr. Grissom referred us to his "email" to Mr. Enerson with the description of the benefit changes and the requested changes to the contribution rate. We then showed Mr. Grissom his February 1996 memo to Mr. Enerson and Mr. Grissom responded that he did not recall the meeting with Mr. McGrory and Mr. Enerson in February 1996 to discuss the manager's proposal.

When we asked Mr. Grissom to describe his role in regards to the 1996 manager's proposal, Mr. Grissom responded that he served as the "facilitator" at Mr. McGrory and Mr. Herring's request.

We asked again about fiduciary's counsel role in the 1996 manager's proposal. Mr. Grissom said that the City had retained its own fiduciary counsel at that time. He again confirmed that he did not recall the reasons for the change in SDCERS' fiduciary counsel.

Mr. Grissom described the process for the manager's proposal – Mr. McGrory presented the proposal to the Board and Mr. Grissom followed up with a detailed report to the Board.

Regarding retiree health, Mr. Grissom explained that the San Diego City Charter changed around 1996 or 1997 so that SDCERS could be the "conduit" for retiree health payments. Mr. Grissom further explained that the City made one contribution to SDCERS that was split between SDCERS 401(a) and the health plan 401(h). He further explained that the 401(h) was essentially funded through excess earnings.
When we asked Mr. Grissom if the 1996 benefits were contingent upon Board approval of the 1996 manager's proposal, he responded that it was not clear. He said that it was more clear in 2002 that the benefits were contingent.

We asked Mr. Grissom to explain when the 2002 benefits were approved. He responded that the City Council officially approved the benefits at the City Council meeting on November 18, 2002; although he "conjectured" that they had been approved in concept in May 2002 after the meet and confer process. He said that if the unions and the city had not approved to the benefits in concept, he would not have embarked on all of the ensuing steps. Mr. Grissom stated that Lexin, Webster, Rhodes, Saathoff and Torres were the Board members who also had involvement with the unions in 2002 and would have known that the benefits and the Board approval were contingent.

We asked Mr. Grissom what would have happened to the benefits if the Board had not approved the 2002 manager's proposal. He responded that he does not know. However, he said that SDCERS had begun the process of implementing changes in July 2002 to facilitate administering the benefits.

We asked Mr. Grissom if and when the Board was aware of Saathoff's presidential leave benefits. Mr. Grissom said that the Board knew in concept about the benefits in the May-July 2002 time frame because several of the Board members were involved in the meet and confer process (Webster, Vattimo, Torres, Lexin possibly).

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We asked Mr. Grissom if there were other benefits awarded to certain people or certain groups of individuals. Mr. Grissom explained the grandfathering concept as it related to city employees who started before the age of 24. He said the benefits for that group of people was based on the mathematics. Mr. Grissom said that he opposed the idea due to the complexities in administering the benefit. Mr. Grissom did not consider it a side deal (which Mr. Hennigan later clarified means that only the person benefiting and the deal maker are aware of the arrangement).

We asked Mr. Grissom if Mr. Blum knew about Mr. Saathoff's presidential leave benefit. Mr. Grissom responded that Mr. Blum probably did not know about it. Mr. Grissom said that Blum's evaluation focused on the reduction of the funding trigger from 82.3 percent to 75 percent. Mr. Grissom said that Blum worked with Elmer Heap and Bruce Herring regarding the language of the proposal. Mr. Grissom stated there were disagreements regarding the language which was the reason for the delay until November.

Mr. Grissom said the items for consideration in the 2002 manager's proposal related to the change in the funding trigger, the five year ramp up, the increase from 50 basis points to 100 basis points and the indemnification clause.

Mr. Grissom said that Mr. Blum suggested the written agreement. Since there hadn't been a written document for the 1996 manager's proposal, there had been debate about the results of hitting the 82.3 percent trigger.

Mr. Grissom confirmed that he has known Bob Blum for approximately twelve years. During that time, Mr. Blum had worked for Orrick, Herrington, Mercer and Hanson Bridget. Mr. Blum had provided services to SDCERS while employed by each of these companies. Mr. Grissom said that he had not spoken to Mr. Blum since 2003.

We asked Mr. Grissom about any pressure he or others placed on Mr. Blum and Mr. Roeder to approve the 2002 manager's proposal. Mr. Grissom responded that he did not pressure anyone. He requested that they provide an opinion either supporting it or not supporting it. He said whatever they concluded was fine as long as it was a conclusion.

We asked Mr. Grissom when he knew about the decreased funding ratio. He responded that there had been lots of discussion about the funding ratio in 2002. He said he believed it was in the 80% to 84% range in early 2002. He instructed Mr. Roeder, and he followed the practice himself, not to discuss the funding ratio until it was finalized in January 2003. As a result, he waited to respond to the Blue Ribbon Committee report until he had the final numbers.

We concluded the interview with the agreement that we would resume on Wednesday, December 14, 2005 at 11am.